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No. 06-480

In the Supreme Court of the United States

LEEGIN CREATIVE LEATHER PRODUCTS, INC.,
PETITIONER

v.

PSKS, INC., dba KAY'S KLOSET... KAY'S SHOES

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Whether vertical minimum resale price maintenance agreements should be deemed per se illegal under Section 1 of the Sherman Act, 15 U.S.C. 1, or whether they should instead be evaluated under the rule of reason.

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INTEREST OF THE UNITED STATES

The United States Department of Justice and the Federal Trade Commission have primary responsibility for enforcing the federal antitrust laws. The question in this case is whether an agreement between a supplier and its dealer that sets the dealer's minimum retail price constitutes a per se violation of Section 1 of the Sherman Act, 15 U.S.C. 1, or is instead properly analyzed under the rule of reason. The Court's resolution of that question may affect both federal antitrust enforcement and the extent to which private enforcement of the antitrust laws achieves its intended purpose.

STATEMENT

1. Petitioner manufactures women's accessories, including handbags, shoes, and jewelry, that are sold through retailers under the Brighton brand. Pet. App. 2a, 19a n.1. In 1997, petitioner instituted the "Brighton Retail Pricing and Promotion Policy," under which it would sell its products to only those retailers that followed its suggested resale prices. Subsequently, as part of a new marketing initiative, petitioner insisted that its retailers pledge to comply with petitioner's pricing policy in order to become a Brighton Heart Store. *Id.* at 2a.

Respondent is a retailer of Brighton products. After learning that respondent had discounted its entire line of Brighton products, petitioner suspended all shipment of its products to respondent. "As a result, [respondent's] sales and profits decreased substantially." Pet. App. 3a.

Respondent filed the instant suit, alleging that petitioner had "entered into illegal agreements with retailers to fix Brighton products' prices and terminated [respondent] as a result of those agreements," in violation of the Sherman Act, 15 U.S.C. 1. Pet. App. 3a. Petitioner sought to introduce into evidence the report of its expert economist, Professor Kenneth Elzinga, who concluded that petitioner's "business model, including its use of Suggested Retail Prices, is procompetitive." *Id.* at 18a, 20a. Relying on this Court's decision in *Dr. Miles Medical Co.* v. *John D. Park & Sons Co.*, 220 U.S. 373 (1911) (*Dr. Miles*), the district court excluded Professor Elzinga's report on the ground that "[v]ertical minimum price fixing agreements * * * remain per se unlawful." Mem. Op. and Order 4 (Mar. 25, 2004). The jury found petitioner liable and awarded damages of $1.2 million. Pet. App. 7a.

2. The court of appeals affirmed. Pet. App. 1a-11a. Petitioner did not challenge the jury's finding that it had entered into an agreement to fix the minimum price at which its dealers would sell its products, but rather challenged the application of a per se rule to its conduct. *Id.* at 3a. The court of appeals rejected petitioner's contention, concluding that it "remain[ed] bound by [this Court's] holding in *Dr. Miles*." *Id.* at 4a. The court of appeals also found that the trial court had properly excluded Professor's Elzinga's report. The court explained that "[w]ith the *per se* rule, expert testimony regarding economic conditions and the pricing policy's pro-competitive effects is *not* relevant." *Id.* at 5a-6a.

SUMMARY OF THE ARGUMENT

The per se rule against vertical minimum resale price maintenance (RPM) established in *Dr. Miles* is irreconcilable with this Court's modern antitrust jurisprudence and cannot withstand analysis. That per se rule should be abandoned, and *Dr. Miles* should be overruled.

A. This Court's antitrust decisions make clear that the presumptive standard for assessing the legality of challenged conduct is the rule of reason, which examines the reasonableness of a given restraint in the context of a particular case. Per se condemnation of economic restraints under Section 1 of the Sherman Act, 15 U.S.C. 1, is thus exceptional, and is reserved for restraints that always, or almost always, reduce consumer welfare by limiting competition and output. Per se treatment is inappropriate when the economic impact of the type of conduct at issue is not obviously and predictably anti-competitive.

B. Because the effects of RPM can be either anti-competitive or procompetitive depending on the facts in

a given case, a per se rule is clearly inappropriate. There is a widespread consensus of opinion that RPM, like non-price vertical restraints, can have a variety of procompetitive effects that enhance consumer welfare. By reducing *intra*brand competition, RPM can stimulate *inter*brand competition by giving retailers incentives to promote the manufacturer's brand in ways that are desirable for both consumers and the manufacturer. RPM may ensure sufficient margins and incentives for retailers to engage in beneficial point-of-sale services, because it prevents "free riding" by price-cutting dealers that would otherwise make it unprofitable for retailers to incur the cost of providing those services. That potential is magnified by the advent of high-volume Internet retailers. Even absent free riding, RPM may give retailers economic incentives to make additional non-price sales efforts, such as investing in attractive stores and locations or stocking greater quantities of a product in the face of uncertain consumer demand. And, at least for some products, RPM may also serve the manufacturer's interest in preserving brand reputation and consumer loyalty.

C. The reasons suggested for continuation of a per se rule are unpersuasive. The decision in *Dr. Miles* is premised on outdated rationales and principles that have been undermined by subsequent decisions of this Court and cannot withstand modern economic analysis. Common law concerns about restraints on alienation are not relevant to whether a practice is so likely to be anticompetitive as to warrant per se condemnation. Moreover, the belief expressed in *Dr. Miles* that RPM is the functional equivalent of a price-fixing agreement among dealers comports with neither fact nor logic; manufacturers are typically the source of RPM require-

ments, yet they have no economic incentive to enrich dealers with supra-competitive profits while reducing their own sales.

To be sure, RPM limits intrabrand price competition and in some circumstances can harm consumer welfare by supporting cartel efforts by manufacturers or dealers. But non-price vertical restraints can also harm consumer welfare, yet they are subject to the rule of reason. *Continental T.V., Inc.* v. *GTE Sylvania Inc.*, 433 U.S. 36 (1977). Nor is there any basis for presuming that RPM will always or almost always support cartel efforts. Likewise, indirect indication of past congressional support for the per se rule of *Dr. Miles* does not counsel against this Court's revisiting the issue in light of subsequent decisions and modern economic analysis.

D. The principle of stare decisis does not justify reaffirmation of *Dr. Miles*. That principle has less force in the antitrust context, because Congress expected this Court to give continuing shape to the meaning of the antitrust laws in keeping with "changed circumstances and the lessons of accumulated experience." *State Oil Co.* v. *Khan*, 522 U.S. 3, 20 (1997). That is particularly true with respect to decisions applying the per se rule, rather than the rule of reason, because that choice is based on experience and economic analysis of particular economic behavior. If experience or economic analysis points in a different direction over time, there is no basis for maintaining a clearly outdated rule. This Court thus has overruled per se prohibitions against non-price vertical restraints and maximum vertical price restraints when "the theoretical underpinnings of those decisions" have been "called into serious question." *Id.* at 21. There is no justification for retaining an anomalous per se ban on

RPM that has no basis in modern antitrust doctrine or experience.

ARGUMENT

THIS COURT SHOULD OVERRULE *DR. MILES* AND SUBJECT RESALE PRICE MAINTENANCE TO THE RULE OF REASON

The decision in *Dr. Miles* was based on reasoning and economic assumptions that predate and conflict with modern economic theory. More importantly, the per se ban on RPM cannot survive subsequent decisions of this Court, which make clear that per se condemnation is appropriate only for those categories of conduct that are manifestly anticompetitive. Thus, in *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36 (1977), the Court overruled the per se prohibition against vertical nonprice agreements established by *United States* v. *Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), because such agreements could not be shown to meet the demanding standards for imposition of a per se rule. Similarly, this Court in *State Oil Co.* v. *Khan*, 522 U.S. 3 (1997), overruled the per se ban on vertical maximum price-fixing agreements established by *Albrecht* v. *Herald Co.*, 390 U.S. 145 (1965), in light of subsequent cases and the absence of a sufficient economic justification for a per se rule. Similar considerations compel the conclusion that *Dr. Miles* should be overruled, and that RPM should be evaluated under the same rule-of-reason standard that applies to other vertical agreements.

A. Per Se Condemnation Applies Only To Restraints That Are Almost Invariably Anticompetitive

1. Section 1 of the Sherman Act, 15 U.S.C. 1, declares every "contract, combination * * *, or conspiracy, in

restraint of trade * * * to be illegal." In *Dr. Miles*, this Court declared unlawful vertical agreements between a supplier of patent medicines and the wholesalers and retailers of its products concerning the minimum price at which they resold the supplier's medicines. Subsequent decisions of this Court have read *Dr. Miles* to have established a per se rule under which RPM is unlawful without any inquiry into its competitive effects in a particular case. *NYNEX Corp.* v. *Discon, Inc.*, 525 U.S. 128, 133 (1998); *GTE Sylvania*, 433 U.S. at 51 n.18; *Business Elecs. Corp.* v. *Sharp Elecs. Corp.*, 485 U.S. 717, 733 (1988); *United States* v. *Bausch & Lomb Optical Co.*, 321 U.S. 707, 720 (1944); *United States* v. *Trenton Potteries*, 273 U.S. 392, 401 (1927).

Dr. Miles was decided at the dawn of this Court's antitrust jurisprudence. Subsequent decisions have considerably clarified, and modified, the proper approach to antitrust analysis. In particular, decisions post-dating *Dr. Miles* have made clear that "most antitrust claims are analyzed under a 'rule of reason,'" which requires evaluation of the reasonableness of the challenged restraint in the factual context of a specific case. *Khan*, 522 U.S. at 10; *GTE Sylvania*, 433 U.S. at 49 (observing that the rule of reason is "the prevailing standard.").

By contrast, this Court has concluded that per se condemnation, which obviates the need for proof of the arrangement's effect in a given case, is to be reserved for restraints that are "manifestly anticompetitive," *GTE Sylvania*, 433 U.S. at 49-50, and "would always or almost always tend to restrict competition and decrease output." *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.* v. *Pacific Stationery & Printing Co.*, 472 U.S. 284, 289-290 (1985)). Under modern antitrust principles, therefore, a per se rule is appropri-

ate only for those restraints, such as horizontal price agreements among competitors, that have a "pernicious effect on competition and lack * * * any redeeming virtue." *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958).

2. The determination that a specific practice should be treated as unlawful per se must rest upon experience in analyzing the practice and examining "the actual impact of these arrangements on competition." *White Motor Co.* v. *United States*, 372 U.S. 253, 263 (1963). Any "departure from the rule-of-reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line-drawing." *GTE Sylvania*, 433 U.S. at 58-59. Per se condemnation is "appropriate '[o]nce experience with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it." *Khan*, 522 U.S. at 10 (brackets in original (quoting *Arizona* v. *Maricopa County Med. Soc'y*, 457 U.S. 332, 344 (1982)).

Application of a per se rule embodies a generalization that "certain kinds of agreements will so often prove so harmful to competition and so rarely prove justified that the antitrust laws do not require proof that an agreement of that kind is, in fact, anticompetitive in the particular circumstances." *NYNEX Corp.*, 525 U.S. at 133. "Cases that do not fit the generalization may arise, but a *per se* rule reflects the judgment that such cases are not sufficiently common or important to justify the time and expense necessary to identify them." *GTE Sylvania*, 433 U.S. at 50 n.16. This Court has accordingly been "reluctan[t] to adopt *per se* rules with regard to 'restraints imposed in the context of business relationships where the economic impact of certain practices is not immediately

obvious.'" *Khan*, 522 U.S. at 10 (quoting *FTC* v. *Indiana Fed'n of Dentists*, 476 U.S. 447, 458-459 (1986)).

B. Resale Price Maintenance Does Not Meet This Court's Criteria For Application Of A Per Se Rule

This Court has never analyzed the likely economic effects of RPM, much less found that RPM has a predictably "pernicious effect on competition and lack[s] * * * any redeeming virtue." *Northern Pac. Ry.*, 356 U.S. at 5. Because RPM agreements have been unlawful since the *Dr. Miles* decision in 1911, moreover, lower courts have been precluded from considering evidence of the competitive purposes and effects of particular RPM agreements. Thus, the per se prohibition against RPM has never been justified in accordance with the high standards for imposition of per se rules enunciated in *Northern Pacific* and subsequent decisions of this Court. It is clear that RPM falls far short of the current standard for per se condemnation of a practice.

Although RPM may have anticompetitive effects in a particular case, there is no basis "to predict with confidence that the rule of reason will condemn it" because the practice is invariably or almost invariably anticompetitive and lacking in any redeeming social value. *Khan*, 522 U.S. at 10 (quoting *Maricopa Co. Med. Soc'y*, 457 U.S. at 344). To the contrary, there is a widespread consensus that permitting a manufacturer to control the price at which its goods are sold may promote *inter*brand competition and consumer welfare in a variety of ways. Because "the primary purpose of the antitrust laws is to protect interbrand competition," *Khan*, 522 U.S. at 15; *GTE Sylvania*, 433 U.S. at 52 n.19, RPM cannot be classified as a manifestly anticompetitive practice worthy of per se condemnation.

As Justice White observed in his concurring opinion in *GTE Sylvania*, moreover, "[i]t is common ground among the leading advocates of a purely economic approach to the question of distribution restraints that the economic arguments in favor of allowing vertical restraints generally apply to vertical price restraints as well." 433 U.S. at 69 (White, J., concurring). In reality, "the economic effect of * * * unilateral and concerted vertical price setting, agreements on price[,] and nonprice restrictions * * * is in many, but not all, cases similar or identical." *Monsanto Co.* v. *Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984). Thus, as Justice White correctly concluded, the Court's decision to subject vertical non-price restraints to the rule of reason in *GTE Sylvania* "necessarily * * * calls[s] into question" application of the per se rule to vertical price restraints generally. 433 U.S. at 70 (White, J., concurring). There is simply no basis for subjecting RPM to per se analysis while analyzing nonprice vertical restraints and maximum resale price maintenance under the rule of reason.

1. RPM will often have procompetitive justifications because it can stimulate interbrand competition

A manufacturer naturally seeks to make additional sales by better serving consumers' interests. Those interests are not limited to low prices, but may include other factors such as access to product demonstration and service; convenience of store hours and location; and knowledgeable, pleasant, and efficient sales personnel. Unless the manufacturer sells directly to consumers, it must rely on its retailers to help it achieve its goals. The interests of retailers and manufacturers, however, do not always coincide. While manufacturers generally benefit from dealer efforts to increase sales by lowering retail

prices, in some circumstances other forms of sales efforts may better serve the interests of both consumers and manufacturers, even if not the dealers.

By fixing the minimum price at which the good may be sold (and thus guaranteeing the retailer a certain margin over the cost of the good to the retailer), RPM provides retailers with an incentive to expend resources in order to attract additional customers for that product, thereby furthering the manufacturer's competitive goals. RPM thus can have the same types of procompetitive effects recognized in *GTE Sylvania* with respect to nonprice vertical restraints such as exclusive territories. "Resale price maintenance, like other vertical restraints, is typically a response to a supplier's problem of inducing distributors to provide adequate levels of distribution for its products." Section of Antitrust Law, ABA, *Antitrust Law and Economics of Product Distribution*, 58 (2006); Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J. L. & Econ. 285, 322-325 (1996) (concluding that RPM challenged by the FTC was most likely employed to increase distribution of the products). In other words, by limiting intrabrand price competition, the manufacturer may induce its distributors to provide promotional services and sales efforts and thereby increase the attractiveness of the product. RPM thus may "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." *GTE Sylvania*, 433 U.S. at 54.

"For example, new manufacturers and manufacturers entering new markets can use [RPM] in order to induce * * * retailers to make the kind of investment of capital and labor that is often required in the distribution of

products unknown to the consumer." *GTE Sylvania*, 433 U.S. at 55; see Pet. App. 36a (Elzinga Report) ("Leegin's pricing policy is designed to induce and incent store-owners and sales personnel to promote the Brighton line, and to enable Leegin to compete with larger department stores offering more prominent brands."). "Established manufacturers can use [RPM] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their product." *GTE Sylvania*, 433 U.S. at 55.

RPM thus accomplishes directly what nonprice vertical restraints accomplish indirectly. *Business Elecs. Corp.*, 485 U.S. at 727-729; *Monsanto*, 465 U.S. at 762; accord Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 Antitrust L.J. 135, 156 (1984) (Easterbrook). As this Court has acknowledged, "all vertical restraints, including the exclusive territory agreement held not to be *per se* illegal in *GTE Sylvania*, have the potential to allow dealers to increase 'prices' and can be characterized as intended to achieve just that." *Business Elecs.*, 485 U.S. at 728. "In fact, vertical nonprice restraints only accomplish the benefits identified in *GTE Sylvania* because they reduce intrabrand price competition to the point where the dealer's profit margin permits provision of the desired services." *Ibid.* Like other vertical restraints, therefore, RPM has complex competitive effects because of its "simultaneous reduction of intrabrand competition and stimulation of interbrand competition." *GTE Sylvania*, 433 U.S. at 51-52.

2. RPM may reduce retailers' incentives to engage in free riding

"There is a consensus in the economic literature that minimum RPM can, in certain circumstances, remedy a

free-riding problem and thereby increase competition and enhance consumer welfare." Economists Pet. Stage Amici Br. 5 (Economists Br.). The most prominent pro-competitive rationale for RPM is that it may alleviate a free-riding problem when retailers incur costs to promote the manufacturer's brand through point-of-sale services. For example, a manufacturer may want its retailers to provide an in-store demonstration or exhibition of a product's features and selections. Such services may be the best way to educate consumers about the product and to promote sales. As is the case with vertical non-price restraints, see *GTE Sylvania*, 433 U.S. at 55, however, an individual retailer has an incentive to free ride on the provision of those services by rival retailers. A retailer offering no services but a lower price can sell to consumers who have been educated by retailers that do provide the services desired by the manufacturer and the consumer. The problem is exacerbated by catalog retailing and the advent of the Internet, as consumers may visit traditional, brick-and-mortar retailers to examine a product and select its features but then purchase the product at a discounted price from a catalog or on-line retailer, whose very lack of "bricks and mortar" affords point-of-sale services impossible and whose lack of expenses for bricks and mortar gives them a competitive advantage over traditional retailers who provide the services that some manufacturers desire.

If free riding is extensive, few if any retailers will incur the costs necessary to provide the services for product promotion, and consumers will not be educated about the manufacturer's product, "despite the fact that each retailer's benefit would be greater if all provided the services than if none did." *GTE Sylvania*, 422 U.S. at 55; accord *Business Elecs.*, 485 U.S. at 731; *Monsanto*,

465 U.S. at 762. RPM reduces or eliminates the incentive to free ride by eliminating the opportunity to attract customers through price cutting. Lester G. Telser, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & Econ. 86, 89-96 (1960).

Manufacturers similarly may rely on RPM to give certain prestige retailers an incentive to stock and promote the manufacturer's product. Prestige retailers have developed reputations for stocking only high quality or especially fashionable products, which may be costly for the retailers to identify. Many customers may evaluate products largely on the basis of the stocking choices made by the prestige retailers—an effect known as quality certification or signaling. Other retailers may seek to sell at a discount the same products stocked by prestige retailers, thereby free riding on the prestige retailers' quality certifications. When quality certification is important to consumers, a manufacturer's best strategy may be to impose RPM, which induces prestige retailers to carry its product when free riding otherwise would make it unprofitable to do so. Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 Antitrust L.J. 59, 65-67 (1994) (Marvel); Howard P. Marvel & Stephen McCafferty, *Resale Price Maintenance and Quality Certification*, 15 Rand J. Econ. 346 (1984) (Marvel & McCafferty); Ronald N. Lafferty et al., *Impact Evaluations of Federal Trade Commission Vertical Restraints Cases* 34-35 (FTC 1984); Thomas R. Overstreet, Jr., *Resale Price Maintenance: Economic Theories and Empirical Evidence* 56-62 (FTC 1983) (Overstreet).

3. RPM may promote the sale of the manufacturer's product even absent free riding

Even in the absence of free riding, RPM may help the manufacturer encourage retailers to sell its products vis-a-vis rival brands.[1] By ensuring retailers an adequate margin over the wholesale price of the product, RPM provides retailers with an incentive to make non-price sales efforts that attract customers away from other brands. Such sales efforts extend beyond product exhibition and demonstration, on which other retailers can free ride, and include such factors as the attractiveness and location of retail stores and the speed and efficiency with which retailers complete customer transactions, factors that do not lend themselves to free riding by other retailers. A retailer can increase its sales either by cutting prices or by increasing sales efforts, but the manufacturer's sales will not increase unless the retailer takes steps to take sales from rival brands. Manufacturers can give retailers an incentive to compete harder against rival brands by using RPM to ensure that retailers compete in non-price areas and can make a profit while providing the manufacturer's desired level of sales efforts. Frank Mathewson & Ralph Winter, *The Law and Economics of Resale Price Maintenance*, 13 Rev. Indus. Org. 55, 67-69, 72-73 (1998); Ralph A. Winter, *Vertical*

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[1] It is always in the interest of the manufacturer to make its product attractive to consumers, and controlling retailer discounting may be seen as an important component of a strategy to do so. Petitioner explains that "it was [petitioner's] view that the typical retail strategy of putting products on and off 'sale' degrades a manufacturer's brand by causing customers to feel cheated when they buy at the wrong moment." Pet. 3. In addition, price may be associated with a brand's reputation and identity.

Control and Price Versus Nonprice Competition, 108 Q.J. Econ. 61 (1993).

RPM also may encourage retailers to stock the product at the manufacturer's desired level when uncertainties in consumer demand could otherwise limit the quantity purchased by the retailer. Although retailers typically charge high prices to consumers when demand is strong and low prices when demand is weak, under certain circumstances, RPM may cause retailers to charge lower prices than they otherwise would when demand is strong because RPM limits the retailers' losses when demand is weak. Thus, RPM may induce retailers to carry larger inventories, benefitting both the manufacturer and consumers by assuring the continuous availability of the brand to consumers. Raymond Deneckere et al., *Demand Uncertainty and Price Maintenance: Markdowns as Destructive Competition*, 87 Am. Econ. Rev. 619 (1997); Raymond Deneckere et al., *Demand Uncertainty, Inventories, and Resale Price Maintenance*, 111 Q.J. Econ. 885 (1996).

C. The Various Justifications That Have Been Offered For The Per Se Ban On RPM Do Not Withstand Scrutiny

1. Dr. Miles's *reasoning has been thoroughly undermined by this Court's precedents*

a. In rejecting the manufacturer's claim that it was entitled to control the price at which its goods would be sold, *Dr. Miles* relied on the common law proposition that "a general restraint upon alienation is ordinarily invalid." 220 U.S. at 404. In *Business Electronics*, 485 U.S. at 733, this Court described *Dr. Miles*'s per se rule as "based largely on the perception that [a RPM] agreement was categorically impermissible at common law" as "an unlawful restraint on alienation."

As this Court observed in *GTE Sylvania*, however, the common law notion disfavoring restraints on alienation has been subjected to near-universal criticism by antitrust commentators. 433 U.S. at 53 n.21. While that common-law rule may have had resonance with the *Lochner*-era Court, it has limited utility in interpreting the antitrust statutes. The *GTE Sylvania* Court refused to rely on that "ancient rule," holding instead that "the state of the common law 400 or even 100 years ago is irrelevant" to modern antitrust analysis. *Ibid.* (quoting *Arnold, Schwinn & Co.*, 388 U.S. at 392 (Stewart, J., dissenting)). Accordingly, the principal rationale relied upon by the *Dr. Miles* decision is invalid, and cannot justify continued maintenance of the per se ban on RPM.

In *Simpson* v. *Union Oil Co.*, 377 U.S. 13, 16 (1964), the Court identified a closely related rationale for the *Dr. Miles* rule, stating that RPM injured commerce because it was "depriving independent dealers of the exercise of free judgment" in selling the product at a price determined by the dealer. But, of course, dealers remain free to exercise their judgment in deciding to enter a contractual relationship with a supplier. Equally important, the suppliers who perceive significant benefits from controlling retail prices retain the freedom to terminate non-complying dealers, see *United States* v. *Colgate & Co.*, 250 U.S. 300, 306-307 (1919), or even to enter the retail market themselves and eliminate the independent retailers (and their free judgment) altogether. For that reason, the Court held in *Khan*, 522 U.S. at 16, that "interfere[nce] with dealer freedom" could not support a per se ban on vertical maximum price fixing. Thus, the goal of protecting "dealer freedom" cannot support the continued application of the per se prohibition against RPM. And in any event, "impairment

of dealer freedom alone is not sufficient to constitute an unreasonable restraint of trade." 8 Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* ¶1609, at 114-115 (2d ed. 2004); see *GTE Sylvania*, 433 U.S. at 53 n.21.

b. The Court in *Dr. Miles* also expressed the view that greater profits from RPM would benefit the dealers, not the manufacturer, and the Court reasoned that RPM would be equivalent to a price-fixing agreement among dealers. 220 U.S. at 407-408. But RPM generally emanates from the *manufacturer*, who has no economic incentive to encourage supra-competitive prices by its dealers. Quite to the contrary, a price-fixing conspiracy at the retail level presumably would reduce quantities sold and thereby reduce the manufacturer's profits. Richard A. Posner, *Antitrust Law* 177 (2d ed. 2001); Robert H. Bork, *The Antitrust Paradox*, 33, 288-290 (1978); see *GTE Sylvania*, 433 U.S. at 56 n.24 ("Generally a manufacturer would prefer the lowest retail price possible, once its price to dealers has been set, because a lower retail price means increased sales and higher manufacturer revenue.") (quoting Recent Case, *Antitrust Laws—Sherman Act—Vertical Restraints: Enforcement of Resale Location Restrictions is a Per Se Violation of Section One of the Sherman Act*, 88 Harv. L. Rev. 636, 641 (1975)). As Justice Holmes' dissenting opinion in *Dr. Miles* pointed out, the manufacturer is in the best position to determine "what will enable it to do the best business." 220 U.S. at 412.

2. The remaining proffered justifications for the per se rule do not support its retention

a. In *GTE Sylvania*, the Court suggested possible reasons that could justify the continued per se illegality of RPM and distinguish RPM from nonprice vertical restraints. 433 U.S. at 51 n.18. None of the concerns ex-

pressed in *GTE Sylvania* justifies the continued characterization of RPM as a per se offense.

First, the Court noted Justice Brennan's earlier assertion in his concurring opinion in *White Motor Co.*, 372 U.S. at 268, that, unlike vertical nonprice restraints, RPM "almost invariably" reduces interbrand competition. But Justice Brennan did not identify any theoretical explanation or empirical support for that assertion, and the intervening years have not filled either void. To the contrary, as the Court recognized in *GTE Sylvania* itself, the impact of vertical restraints is generally *constrained* by interbrand competition: "when interbrand competition exists, * * * it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product." 433 U.S. at 52 n.19. And if a manufacturer does possess interbrand market power, it is not likely to use RPM as a way to raise resale prices; if elevation of resale price were the manufacturer's ultimate purpose, the manufacturer could simply raise its own price to the distributor and thereby keep for itself any higher revenues resulting from the higher price.

Economists have observed, moreover, that nonprice vertical restraints, such as exclusive territories, can more completely restrict intrabrand competition than does RPM. While exclusive territorial restrictions can eliminate virtually all intrabrand competition, RPM permits retailers to engage in intrabrand competition on factors other than price, "leav[ing] multiple sellers of the brand in the same geographic market to engage in interbrand competition." Economist Br. 17; Richard A. Posner, *The Next Step in Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. Chi. L. Rev. 9 (1981) ("Resale price maintenance is more flexible than

exclusive territories as a method of limiting price competition among dealers.").

Second, the Court in *GTE Sylvania* noted that RPM may facilitate cartelization. 433 U.S. at 51 n.18.[2] That possibility is a reason to subject RPM to the rule of reason. However, there is no basis in evidence or experience to predict that RPM "would always or almost always" be condemned under that standard. *Business Elecs.*, 485 U.S. at 723 (quoting *Northwest Wholesale Stationers, Inc.*, 472 U.S. at 289). Studies of RPM cases over many years have found relatively few instances of such anticompetitive uses of RPM. An analysis of all litigated RPM cases during 1976-1982 concluded that "collusion theories do not seem capable of explaining at least 85 percent of the cases." Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & Econ. 263, 292 (1991).[3] In any event, all cartel agreements are illegal per se, regardless

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[2] Manufacturers could use RPM, particularly when combined with exclusive dealing arrangements with their retailers, to facilitate a price-fixing conspiracy by enhancing their ability to detect departures from agreed-upon prices. In addition, retailers might act collectively to coerce a manufacturer to institute RPM as a means of thwarting competition from a discounting retail competitor. *Business Elecs.*, 485 U.S. at 725-726; Howard P. Marvel & Stephen McCafferty, *The Welfare Effects of Resale Price Maintenance*, 28 J.L. & Econ. 363, 365-369, 373-378 (1985); Overstreet 13-23.

[3] Another study found that only 7% of the horizontal conspiracy cases filed by the Department of Justice during 1890-1983 involved resale price maintenance. Stanley I. Ornstein, *Resale Price Maintenance and Cartels*, 30 Antitrust Bull. 401, 416-417 (1985). The same study found that only 10% of RPM complaints brought by the FTC during 1942-1983 involved cartels. *Id.* at 423. Still another report found that a "substantial portion of the [FTC]'s RPM enforcement efforts [from 1965-1982] have been concentrated in markets which appear to be structurally competitive." Overstreet 74.

of whether the cartel uses RPM. And the rule of reason would condemn any RPM demonstrated to be a means of supporting a cartel. Cf. *Khan*, 522 U.S. at 22 ("In our view, rule-of-reason analysis will effectively identify those situations in which vertical maximum price fixing amounts to anticompetitive conduct.").

Third, the Court in *GTE Sylvania* also cited past congressional action as indicating congressional "approval of a *per se* analysis of vertical price restrictions." 433 U.S. at 51 n.18. The Court referred to the Consumer Goods Pricing Act of 1975, Pub. L. No. 94-145, 89 Stat. 801, amending 15 U.S.C. 1, 45(a) (1970), which had repealed provisions of earlier statutes which allowed "fair trade" pricing, *i.e.*, RPM, at the option of individual States. Congress subsequently enacted temporary prohibitions, no longer in effect, on the Department of Justice's use of appropriated funds to advocate the overruling of *Dr. Miles*. J. Res of Nov. 14, 1983, Pub. L. No. 98-151, §101(e), 97 Stat. 973; Act of Nov. 28, 1983, Pub. L. No. 98-166, §510, 97 Stat. 1102; Act of Dec. 13, 1985, Pub. L. No. 99-180, §605, 99 Stat. 1169.

Those congressional enactments do not support the continued existence of a rule that is dramatically out of step with this Court's modern antitrust jurisprudence. As an initial matter, there is no incongruity between Congress's action in 1975 and a more flexible treatment of RPM under the Sherman Act. In repealing the broad per se *legality* afforded by the fair trade laws and once again subjecting RPM to antitrust scrutiny, Congress did not mandate a particular standard to govern such scrutiny. Easterbrook 139. Although both the House and Senate reports on the 1975 legislation indicate Congress's awareness of the reality that by repealing the exemption for fair trade laws they were remitting RPM

to the *Dr. Miles* regime, H.R. Rep. No. 341, 94th Cong., 1st Sess. 3 (1975) (House Rep.); S. Rep. No. 466, 94th Cong., 1st Sess. 1-2 (1975), the legislative history suggests that Congress merely intended to end a special exemption from the Federal antitrust laws that allowed States to declare RPM per se *legal*. House Rep. 5.

In repealing the special exemption for RPM provided by the fair trade laws, Congress did not purport to freeze that status and deprive this Court of its recognized authority and flexibility to interpret the Sherman Act's general language in accordance with our growing understanding of commercial realities. Easterbrook 139. There is thus no support for the notion that Congress intended to preserve a per se ban on RPM even if subsequent developments in the law rendered that ban anomalous and markedly inconsistent with the treatment of other forms of vertical restraints. Likewise, the earlier prohibitions against the Department's use of appropriated funds to advocate *Dr. Miles*'s demise have not been in effect for over 20 years, and in any event are hardly a testament to the robustness of the *Dr. Miles* rule. Congress could have buttressed the *Dr. Miles* rule directly, and more to the point, retains the full ability to address RPM legislatively. If *Dr. Miles* cannot survive as a matter of stare decisis, see pp. 24-28, *infra*, it should no longer skew any congressional debate concerning RPM.[4]

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[4] Congressional views about RPM and *Dr. Miles* have varied over the years. The 1975 legislation, after all, repealed earlier legislation, the Miller-Tydings Fair Trade Act, ch. 690, tit. VIII, 50 Stat. 693, and the McGuire Bill, ch. 745, 66 Stat. 631, that had been intended to place "the stamp of approval upon price maintenance transactions under State [fair trade laws], notwithstanding the Sherman Act of 1890." 81 Cong. Rec. 8138 (1937) (statement of Rep. Dirksen).

b. It also has been argued that RPM necessarily harms those customers who are already poised to purchase the manufacturer's product without any special dealer services supported by RPM (so-called "inframarginal" customers). According to that argument, RPM forces inframarginal customers to pay more for a product they would have purchased in any event. William S. Comanor, *Vertical Price-Fixing, Vertical Market Restrictions, and the New Antitrust Policy*, 98 Harv. L. Rev. 983, 990-992 (1985) (Comanor). That argument plainly cannot support per se condemnation. Prices need not go up when RPM causes retailers to provide costly additional services, because the manufacturer, in imposing RPM, may lower its wholesale price to retailers. Marvel 67-71; Marvel & McCafferty 369-373. RPM also may spur greater retail sales efforts that increase total output, allowing the manufacturer to achieve economies of scale.

Second, even if inframarginal customers pay higher prices, other customers receive the benefit of products they find more attractive as a result of the enhanced product information and service. In other words, higher prices resulting from RPM may enhance consumer welfare as a whole because consumers effectively receive a different and better product at the higher price. And third, harm to inframarginal customers will generally be limited as long as interbrand competition exists, "because of the ability of consumers to substitute a different brand of the same product." *GTE Sylvania*, 433 U.S. at 52 n.19.

In any event, the per se prohibition against RPM does not prevent manufacturers from engaging in other conduct that achieves similar results. Prevented from using their preferred—and thus presumably most efficient—

marketing strategy, manufacturers can be expected to adopt the best available alternative to RPM. For example, manufacturers might consider relatively inefficient vertical integration or offer services themselves that could be more efficiently produced by retailers, thereby decreasing consumer welfare. See p. 17, *supra*. Even under the *Dr. Miles* rule, moreover, manufacturers may lawfully adopt a policy of terminating retailers for failure to abide by the manufacturer's suggested retail price, as long as they avoid an agreement. *Colgate & Co.*, 250 U.S. at 306-307. Thus, there is little basis for concern that elimination of the *Dr. Miles* rule will permit RPM that always or almost always harms consumer welfare.

D. Considerations Of Stare Decisis Do Not Justify Retention Of The *Dr. Miles* Rule

1. Although this Court approaches the reconsideration of its prior decisions with the "utmost caution," *Khan*, 522 U.S. at 20, the principle of stare decisis is "not an inexorable command." *Ibid.* (quoting *Payne* v. *Tennessee*, 501 U.S. 808, 828 (1991)). "In the area of antitrust law, there is a competing interest, well represented in [the] Court's decisions, in recognizing and adapting to changed circumstances and the lessons of accumulated experience." *Ibid.* Accordingly, "the general presumption that legislative changes should be left to Congress has less force with respect to the Sherman Act" in light of the accepted view that Congress expected courts to give continuing shape to antitrust law. *Ibid.* That is particularly true in the context of per se rules, which are adopted based on experience and economic analysis and should not survive when experience and economic analysis thoroughly undermine the case for per se treatment.

For those reasons, this Court "has reconsidered its decisions construing the Sherman Act when the theoreti-

cal underpinnings of those decisions are called into serious question." *Khan*, 522 U.S. at 21. In an analogous context, this Court recently overruled its prior decisions establishing a presumption that patents confer market power in the context of a tying case, a presumption that did not comport with modern economic reality. *Illinois Tool Works Inc.* v. *Independent Ink, Inc.*, 126 S. Ct. 1281 (2006). Those decisions reflect this Court's reluctance "to create out of the single term 'restraint of trade' a chronologically schizoid statute, in which a 'rule of reason' evolves with new circumstances and new wisdom, but a line of *per se* illegality remains forever fixed where it was." *Khan*, 522 U.S. at 21. There is similarly no justification for retaining an anomalous per se rule that is based on erroneous reasoning and manifestly does not satisfy this Court's modern test for per se treatment. "With the views underlying [*Dr. Miles*] eroded by this Court's precedent, there is not much of that decision to salvage." *Ibid.*

2. *Dr. Miles*'s per se rule has few, if any, defenders in the scholarly community. See *Khan*, 522 U.S. at 15-18 (relying on scholarly criticism in abrogating per se ban on maximum vertical price restraints). As the brief filed at the petition stage by leading economists aptly summarizes:

> In the theoretical literature, it is essentially undisputed that minimum RPM can have procompetitive effects and that under a variety of market conditions it is unlikely to have anticompetitive effects. The disagreement in the literature relates principally to the relative frequency with which procompetitive and anticompetitive effects are likely to ensue.

Economists Br. 15-16.

Even commentators who emphasize the potential anticompetitive effects of vertical restraints generally endorse some form of rule-of-reason analysis that takes into account the economic and market conditions in any given case. For example, Professor Pitofsky, while generally endorsing *Dr. Miles*'s per se rule, has proposed significant exceptions to the rule in light of modern economic realities. Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 Geo. L.J. 1487, 1488, 1495 (1983).

Similarly, Professor Comanor, who has proposed a per se ban or a "modified rule of reason analysis" for vertical price and nonprice restraints involving "established products," has advocated that, in the case of new products or products of new market entrants, "the restraints should be permissible, or at least should be treated more leniently in any modified rule of reason analysis." Comanor 99, 1001, 1002. Other critics of RPM are no exception. Robert L. Steiner, *How Manufacturers Deal with the Price-Cutting Retailer: When Are Vertical Restraints Efficient?*, 65 Antitrust L.J. 407, 445, 446-447 (1997) (explaining that in some circumstances "the consumer interest is often better served by RPM [as opposed to other vertical restraints]—contrary to its per se illegality and the rule-of-reason status of vertical nonprice restraints"); Warren S. Grimes, *Brand Marketing, Intrabrand Competition, and the Multibrand Retailer: The Antitrust Law of Vertical Restraints*, 64 Antitrust L.J. 83, 135 (1995) (explaining that a "structured rule of reason should be applied to both price and nonprice [vertical] restraints").[5]

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[5] Grimes suggests that, under a properly structured rule-of-reason analysis, RPM would more frequently be found anticompetitive than

3. Continuation of a per se ban on RPM poses significant practical risks to the procompetitive purposes of the antitrust laws. Most saliently, the per se ban on RPM prohibits conduct that would often be efficiency-enhancing and beneficial, with the result that overall economic welfare is reduced. See pp. 9-16, *supra*. Perpetuation of unjustified per se rules also risks undermining the value of per se rules more generally. Per se rules are essential to effective enforcement of the antitrust laws. They establish bright-line tests that identify plainly pernicious conduct, thereby deterring unlawful behavior and providing clear guidance to the business community and antitrust counselors. If a per se rule, once adopted, were to be treated as sacrosanct, it could make courts overly cautious in adopting such rules. Moreover, courts, agencies, and the business community should have confidence that per se rules are applied only to manifestly anticompetitive conduct. Application of a per se rule to conduct that often would be procompetitive has the potential to erode the rationale for per se treatment and foster judicial reluctance to use such a blunt instrument even in those circumstances when it is appropriate.

In *Colgate*, *supra*, the Court held that the antitrust laws permit a manufacturer unilaterally to announce that it will refuse to do business with dealers who sell below the manufacturer's suggested retail price, provided that the dealer does not actually enter into an agreement to maintain retail price. But the distinction between unilateral conduct that is lawful under *Colgate* and an implicit agreement that is illegal per se under *Dr. Miles* is "often * * * difficult to apply in practice." *Monsanto*, 465 U.S. at 762. The distinction has spawned considerable con-

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would some other vertical restraints. Grimes, *supra*, at 119-134. He nevertheless rejects a per se rule in favor of the rule of reason.

cern and uncertainty in the business community and the courts, potentially chilling even procompetitive conduct that might qualify as unilateral under *Colgate*. Cf. *GTE Sylvania*, 433 U.S. at 48 n.14 (discussing distinctions made by lower courts to limit *Schwinn*'s per se reach).

4. Nor does the per se rule of *Dr. Miles* comport with this Court's closely related precedents. As discussed, the Court in *GTE Sylvania* and *Khan* overruled its prior decisions imposing a per se ban on other vertical restraints with effects similar to those of RPM. See pp. 6, 9-10, *supra*. The similarity between RPM and other vertical restraints as to which per se treatment has been abandoned makes the continued survival of *Dr. Miles* impossible to justify. In other contexts, the Court has overruled anachronistic precedents that could not be squared with the reasoning of opinions in closely related cases. *E.g. Lapides* v. *Board of Regents of Univ. Sys.*, 535 U.S. 613, 623 (2002); *Ring* v. *Arizona*, 536 U.S. 584, 602-609 (2002). The same result is appropriate here.

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The time has come to harmonize the law's treatment of RPM with modern antitrust doctrine. There is no sound basis for treating RPM differently from other vertical agreements. The rule of reason offers protection against anticompetitive uses of RPM, while allowing defendants to defend their arrangements as legitimate and procompetitive. Moreover, analyzing RPM under the same standards that govern other vertical restraints will avoid the continued necessity to make tenuous distinctions between economically indistinguishable conduct and will promote proper application of the per se rule, to the benefit of strong antitrust enforcement and a vigorously competitive economy.

CONCLUSION

The judgment of the court of appeals should be reversed and the case remanded for further proceedings.

Respectfully submitted.

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JANUARY 2007